NCCI Response to the 2014 Actuarial Peer Review of the Ratemaking Process of NCCI

NCCI appreciates the opportunity to comment on the report compiled by Oliver Wyman Actuarial Consulting Inc. (“Oliver Wyman”), regarding the ratemaking process of the National Council on Compensation Insurance (“NCCI”) in the State of Florida. We are pleased to note Oliver Wyman’s principal conclusions that NCCI’s ratemaking process in Florida is:

1) Based on commonly applied actuarial methodologies that are supported in actuarial literature as well as frequency of usage by credentialed actuaries.
2) Based on data that is appropriate as respects the actuarial methodologies used in the ratemaking process.
3) Generally consistent over time.

With regard to the specific recommendations in the Oliver Wyman review, NCCI offers the following comments:

Regarding Oliver Wyman’s concern that NCCI’s change from a calendar-accident year based methodology to a policy year based methodology in Florida was not justified

The economic conditions in Florida in recent years had a significant impact on audit premium adjustments, which created a distortion in the calendar-accident year data. In order to minimize the impact of changes in audit premium adjustments, NCCI changed its approach in Florida to use policy year data. The policy year approach is utilized and widely accepted in all other NCCI jurisdictions. If the calendar-accident year approach was still used in Florida, it would be the only jurisdiction of the 38 where NCCI provides ratemaking services.

As noted by Oliver Wyman, switching to a policy year approach resulted in lower rate level changes in each of the last three filings (see the table below). NCCI agrees with Oliver Wyman that this fact, in isolation, does not justify a change in methodology. NCCI’s position is that the audit premium issue distorted the calendar-accident year approach, and that this was the primary factor resulting in a large difference between the two approaches in recent Florida rate level reviews. Oliver Wyman suggests that NCCI could have addressed the audit premium issue by adjusting calendar year earned premium rather than changing to the policy year approach. NCCI considered this alternative during preparation of the last several filings, but ultimately decided against it due to the significant amount of judgment required in estimating audit activity on future policies.

Rate Filing Effective Date	Filed Rate Change Based on Two Policy Years	Indicated Rate Change Based on Two Calendar-Accident Years
1/1/2012	+8.9%	+13.4%
1/1/2013	+6.1%	+13.7%
1/1/2014	+1.0%	+2.9%

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Oliver Wyman also expresses concern that NCCI "consistently underestimated" premium development factors needed for the policy year approach. In each of the last three Florida filings, NCCI consistently selected an average of the latest three available observations to estimate the premium development factors. The use of a three-year average for premium development factors is consistent with the estimated loss development factors, which are also based on a three-year average. As Oliver Wyman notes with the benefit of hindsight, premium development that has emerged in recent years is higher than what was estimated in the January 1, 2012 and January 1, 2013 Florida rate filings. However, other common development averaging techniques would not have yielded a significantly different rate level change. Even if NCCI had perfect knowledge of future premium development, the rate level changes indicated for each of these filings would have been less than 0.5% lower. NCCI selected a consistent, objective estimation method for premium development rather than an alternative method that would not have resulted in a significantly different rate level indication.

In sum, Oliver Wyman concludes that NCCI's decision to change from a calendar-accident year approach to a policy year approach in Florida in recent filings was not justified. Had NCCI used the calendar-accident year approach, the overall rate level indications would have been significantly (1.9% to 7.6%) higher. At the same time, Oliver Wyman notes that the overall rate level indications would have been marginally lower based on actual premium development (in NCCI's estimation, less than 0.5% lower).

Regarding Oliver Wyman's comments on NCCI's use of judgment in analyzing trend

Oliver Wyman is recommending that NCCI select a trend methodology that would be "fixed over time unless there is a compelling reason to change." Oliver Wyman notes however that "there are arguments that fixing all aspects of ratemaking methodology may lead to illogical results when changes occur to the workers compensation system."

NCCI employs a number of techniques to examine historical trends and then uses actuarial judgment to select the going-forward trend assumption. Judgment is particularly appropriate in a state like Florida, where a steady state environment is rarely observed.

In NCCI's opinion, adopting a rigid standard procedure precludes the use of an approach that is most appropriate to each state's condition. Maintaining procedural flexibility allows for the selection of methodologies as indicated by diagnostic information. While NCCI might choose to implement a "standard method," the option must exist to deviate from that method – provided that full explanation is made to the regulator – when conditions require.

Regarding Oliver Wyman's recommendation that NCCI continue to report detailed off-balance information to the Florida OIR

NCCI will continue to provide detailed off-balance information to the Florida OIR as requested.

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Oliver Wyman notes that increasing the average experience modification in Florida would result in a manual rate decrease, but it should be noted that total premium paid by Florida employers would be the same. That is, there would be no net savings to Florida policyholders.

NCCI's research has shown that smaller employers tend to have worse loss experience than larger employers. Therefore, if the average experience rating modification is near 1.000, larger employers would subsidize the poorer experience of smaller policies that do not qualify for experience rating. As a result, NCCI targets an average experience rating modification slightly below 1.000.

As noted by Oliver Wyman, experience rating modification factors sometimes take on an unintended role in the awarding of contracts in the construction industry. Considering the large volume of construction business in the state, increasing the average modification factor could result in a significantly negative impact on the Florida workers compensation market.

Regarding Oliver Wyman's concerns with NCCI's class ratemaking methodology

NCCI regularly reviews different aspects of the ratemaking methodology to determine if improvements can be made and will take Oliver Wyman's concerns under advisement. Since the implementation of the new class ratemaking methodology, NCCI has continually studied the impact of the change on class rates and has reported on this research to the Florida OIR during the rate filing review process.

The class ratemaking methodology used in NCCI's Florida filings has been implemented and accepted in all other jurisdictions in which NCCI provides ratemaking services, as well as several other independent bureau states. The methodology, including the process of limiting of large claims and applying expected excess provisions, is detailed in a paper written by Thomas V. Daley and accepted for publication in the Casualty Actuarial Society's peer-reviewed journal *Variance*.[1] Another *Variance* paper by John P. Robertson describes the manner in which classifications were assigned to hazard groups in 2007.[2]

NCCI is pleased to have participated in the review process conducted under the leadership of Scott Lefkowitz and Oliver Wyman. As we examine and adopt suggestions for improvement, NCCI will continue to make it our priority to support Florida's legislators and regulators as they seek to achieve and maintain a stable and healthy workers compensation system.

[1] Daley, T.V., "Class Ratemaking for Workers Compensation: New Developments in Loss Development" *Variance*, Volume 6, Issue 2, 2012, pp.196-244. http://www.variancejournal.org/issues/06-02/196.pdf

[2] Robertson, J.P., "NCCI's 2007 Hazard Group Mapping" *Variance,* Volume 3, Issue 2, 2009, pp.194-213. http://www.variancejournal.org/issues/03-02/194.pdf

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